

Memo

To: **Montana Grain Growers Association**

From: Terry Whiteside

Date: August 3, 2006

Re: **Transportation Report**



STB MAKES LANDMARK RULING IN EX PARTE NO. 661 - FUEL SURCHARGES

We have talked about the fact that we are seeing a never-ending stream of hearings on the rail competition issue in Congress and at the Surface Transportation – it appears that the STB has stepped up to the plate and set down new rules for carriers collecting fuel surcharges after the hearing held on May 11, 2006. Shippers should take note that these hearings are important sources for input to those who regulate and adjudicate railroads.

Many of our clients were involved in that hearing and this proceeding – and this will come, we believe, as good news that some of your messages were heard and acted upon by the STB.

The STB in a decision issued August 3, 2006, has found:

- Because differences in base rates are not pegged primarily to differing fuel costs, we do not believe that it is a reasonable practice for railroads to compute fuel surcharges as a percentage of existing rates.
- ...railroads should not call a charge a fuel surcharge if it designed to recover more than the incremental cost of fuel attributable to the movement involved. We therefore admonish carriers to reexamine their method for calculating fuel surcharges.
- Some carriers escalate their base rates using an index such as the RCAF (Rail Cost Adjustment Factor) ...which seeks to measure increases in costs that the railroad industry incurs....It is possible that some carriers have been charging twice for the same fuel cost increases, by both escalating the base rate using such

an index.....We believe that engaging in such “double dipping” would also be an unreasonable practice.

Findings:

- STB believes that rate based fuel surcharges do not constitute a ‘reasonable carrier’ practice and they propose to require that fuel surcharges be tied not to the level of the base rates but to those attributes of a movement that directly affect the amount of fuel consumed; either mileage alone, or preferably, weight and mileage.
- Railroads could continue to collect a fuel surcharge if they remove the fuel cost component from the RCAF (or other index) used to escalate the base rate.
- We proposed to require all Class I railroad to use a single, uniform index to measure increases in fuel costs – namely, the EIA’s “U.S. No. 2 Diesel Retail Sales by All Sellers (Cent’s Per Gallon)”
- Lastly, the STB propose in reporting a mechanism that will allow the Board and the shippers better access to monitor railroads’ fuel surcharge practices. Included in the reporting on monthly basis: total expenditures for fuel, total gallons consumed, increase or decrease in cost from the previous month, its revenue tons for the month, and revenue tons to which the fuel surcharge was applied. Further the Board wants a reporting of revenue a Class I (large railroads) collects on joint shipments from Class II and Class III (smaller railroads and shortlines) and report the revenues from fuel surcharges shared with the Class II and Class III carriers.
- The Board also unexempted under 49 U.S.C. 10502(a) exempt commodities (such as lumber) for the purposed and to the extent necessary to apply the measure outlined in this proceeding.

The rationale of the Board it is important here. The Board stated that it believed ‘our obligation in the rail transportation policy (RTP) at 49 U.S.C. 10101 supports the partial revocation here and cited paragraph 9 of the RTP – which states that, in regulating the railroad industry, it is the policy of the United States Government to encourage honest and efficient management of railroads.

The Board wants to ensure that added fuel costs are borne by those for whom the fuel is consumed. This was a recognition by the Board that certain shippers (mostly captive ones) were be burdened by paying more than their fair share of the increases in fuel costs.

This decision is the first in a long while that peeled back the invincibility of the railroads to do exactly what they want without transparency. The STB will now seek comments by September 25, 2006 on these new rules.

STB SETS AMBITIOUS SCHEDULE FOR FALL HEARINGS

EX PARTE NO. 646 - SMALL RATE NPR (NOTICE OF PROPOSED RULE MAKING), JULY 26TH

This NPR comes out of the small rate Ex Parte 646 that the STB had earlier heard (also at the behest of a feisty Congress – over the STB stalling on the small rate rules). The reality is that the STB has not been following stare decisis (adhere to established legal precedents) in its rule making and now it is estimated by transportation practitioners that only 6 companies (all utilities) have the financial wherewithal and type of sustained movement that can support a SAC (Stand Alone Cost) rate case.

The Board has proposed changes -- very substantial changes -- to its small rate case guidelines, both procedurally and substantively.

On the substantive side, the Board has apparently developed a "Simplified Stand-Alone Model" for "mid-size" rate cases. This Simplified Stand Alone model appears to develop simplifying assumptions for the much more complicated Stand Alone Cost model used for large coal rate cases. I would note that, in the last two years, the Board has very substantially increased the maximum reasonable rate standard for large cases, and it is uncertain what will be the effect of applying a "simplified" model in non-coal cases. In addition, the Board has limited the three-factor model that the Board proposed back in 1998 to very small cases. And, the Board has also substantially changed the definitions of the three factors. The substantive effect of all these changes is, at this point, very unclear.

On the procedural side, the Board has set out some standards for who qualifies for the various levels. At first blush, there appears to be some very, very substantial problems with the levels proposed for who qualifies for the various types of cases (full Stand Alone, Simplified Stand Alone, and three-factor cases). One of the issues in the past has been defining a small rate case – which the railroads wanted defined as a small shipper. However, small rate cases can be promulgated by large shippers – as the revenue based might indeed be for a small movement.

There will be an important upcoming rulemaking, and since the final rules that issue from this NPR (Notice of Proposed Rule making) could have a very substantial effect on the legal rights of shippers for a long time to come it will be important that rail shippers participate in these hearings. The captive shippers are thinking about a consolidated approach. These things have a tendency not to be inexpensive.

A notice of intent to file with STB in this NPR is due on September 1, 2006, with written comments due by September 29. Reply submissions are due by October 30, and rebuttal

comments are due by December 1. Thus, there will be three different written submissions required, which will be all the more reason to consider a consolidated approach. Given the Board's recent approach to matters (Ex Parte, NPR having a succession of hearings), I would expect that there would be an oral hearing as well.

SURFACE TRANSPORTATION BOARD ANNOUNCES INTENT TO HOLD FALL 2006 PUBLIC HEARING ON CERTAIN ISSUES RELATED TO RAIL TRANSPORTATION OF GRAIN

Chairman Buttrey indicated at the end of the Fuel Surcharge hearing in May, 2006 to Steve Strege, ED, North Dakota Grain Dealers Association that he intended to separate the wheat from the chaff in the future. Also Chairman Buttrey has been very active meeting with and hearing the concerns of farm producers in the Montana and North Dakota.

The Surface Transportation Board announces its intent to hold a public hearing this Fall to address certain issues related to the rail transportation of grain. On June 21, 2006, the United States Government Accountability Office (GAO) released preliminary observations on rates, competition, and capacity issues in the American rail freight industry. GAO reported that the changes that have occurred in the rail industry since the Staggers Rail Act of 1980 are widely viewed as positive. The financial health of the industry has improved substantially as railroads have cut costs and boosted productivity. Moreover, most rates declined as productivity improvements were passed on to shippers. However, one category of rates examined by GAO--grain rates--diverged from the industry trends. According to the GAO preliminary report, the amount of grain traffic with comparatively high markups over variable cost increased notably between 1985 and 2004.

The Board intends to hold a public hearing after GAO releases its final report, as a forum for interested persons to provide views and information about the market conditions that led to these findings by GAO and about grain transportation markets in general. Because U.S. grain producers compete in a broader North American, and global, marketplace, the Board also anticipates inviting information regarding the interplay between the American and Canadian wheat markets, how the Canadian regulatory system differs from the American system, and what impact those differences might have on grain production in the United States. A date for the hearing will be set once the final GAO findings and recommendations are released.